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SUBJECT: KAZAKHSTAN: SAMRUK'S NEW BOARD CHAIRMAN DEALS WITH
EXPANSION, GOVERNANCE

REF: A) ALMATY 3278, B) Almaty 3178, C) Astana 147

11. (SBU) Summary: On December 8, Sir Richard Harry Evans, the newly appointed Chairman of the Board of Directors of the Samruk State Holding Company, discussed with the Ambassador his uphill battle in establishing proper corporate oversight over the Samruk companies, working with the GOK, and plans for Air Astana. End summary.

12. (SBU) Background: Samruk, the national holding company based on Singapore's Temasek, was established in January to provide state-owned companies with professional management (Ref A). The appointment of Evans as Chairman of the Board in November roughly coincided with the announcement that another 17 companies would join the original five in Samruk's fold. Evans has a prior indirect connection to Samruk: he is the former chairman of BAE Systems, a British giant with a 49% stake in Air Astana. Air Astana, the de facto national airline in which the GOK currently holds a 51% stake, is one of Samruk's 17 "new arrivals."

13. (SBU) The seventeen "new arrivals," along with their state ownership share, are:

In Power Generation and Distribution:

- KazKuat (100%)
- Ekibastuz Energy Center (100%)
- Kazakhstan Electrical Energy & Capacity Operator (100%)
- Mangistauskaya Electrical Distribution & Grid Company (94.25%)
- Shulbinskaya Hydro Power Station (92.13%)
- Bukhtarminskaya Hydro Power Station (90%)
- Ust-Kamenogorskaya Hydro Power Station (89.99%)
- Astana Energy Service (61.72%)
- Kazakh Scientific Research Institute of the Power Sector (50%)

In Transportation:

- Pavlodar Airport (100%)
- Aktobe International Airport (100%)
- Astana International Airport (100%)
- Air Astana (51%)
- National Sea Shipping Company "KazMorTransFlot" (50%)

In Mining and Metals:

- Akbakai Mining & Metals Combine (33%)
- Maikainezoloto (25%)

In Engineering:

- National Company "Kazakhstan Engineering (100%)

14. (SBU) The original five companies subsumed under Samruk's authority are KEGOC (100%), KazMunayGas (100%), KazPochta (100%), Kazakhstan TemirZholy (100%), and KazakhTelecom (55.6%). Ulf Wokurka, Samruk's Deputy Chairman and CFO, told us that there were originally three more candidates for inclusion in Samruk. One of them, KazAtomProm, has been temporarily set aside due to concerns that its Russian partners would object.

"Board Members Are Violating Their Fiduciary Duties"

15. (SBU) Evans told the Ambassador that Samruk has three strategic objectives:

- Professional management: operating "like a real company," adopting international accounting standards, and achieving proper corporate governance;
- Improved performance, derived from better governance; and
- IPO flotations, private placements, etc.

Evans, whose involvement with the company will be part-time, said "I am clear on these goals. I am not sure other people in the organization want the same."

16. (SBU) The focus, Evans said, must be on governance, which means "getting everyone at Samruk on the same page" and implementing a proper accounting system. He stated that there has been no presentation of financial data to the board, leading him to conclude that "all the board members are violating their fiduciary duties." Evans stressed Samruk's need to overcome the Soviet mentality that fails to pursue minimization of inputs in relation to output. "Good governance," he continued, requires bringing into Samruk and its corporate components "truly independent directors."

17. (SBU) The picture painted by Evans of an almost total lack of effective corporate oversight tracks with what we have heard from some other westerners with insight into the inner workings of large Kazakhstani corporations. These observers have privately expressed great skepticism regarding the sustainability of Kazakhstani companies' listings on the London Stock Exchange (LSE). Other foreigners who have worked on the IPOs, however, have claimed that there has been substantial progress in accounting and disclosure during the process of due diligence, a process that took a considerable period of time to meet the LSE's minimal standards.

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(Note: Of the Kazakhstani companies trading on the LSE, only one - KMG E&P, the Exploration & Production subsidiary of KazMunaiGas, is in Samruk. Ref B. End note.) According to these observers, the Kazakhstani IPOs on the LSE have not been accompanied by a significant level of disclosure. At best, this view goes, the London IPOs have failed to force the Kazakhstani companies to reform; at worst, the limited flotations represent little more than a short-term vehicle for company insiders to access the prestige and the capital provided by an LSE listing without introducing proper business practices or significantly diluting their ownership.

Dealing with the GOK: It's a Cultural Thing

18. (SBU) Evans stressed Samruk's need for directors who are "totally independent but know something about these businesses," and asked whether the Ambassador could help in this regard. Evans acknowledged that attracting such talent will be problematic. The government, he said, "has got itself into a corner" by orchestrating the so-called "bonus scandal" (Ref C). As a result, Samruk finds itself unable to provide the salaries necessary to recruit quality management talent, foreign or domestic. The problem, Evans said, is particularly acute in the oil and gas sector: "we provide them with training, they go to foreign companies."

19. (SBU) Evans considers it crucial to establish a proper relationship with the GOK. He said he asked President Nazarbayev "to give Samruk a free hand on remuneration" and "to get rid of the [unbearable] procurement laws." (Note: Wokurka told us earlier of the stifling effect of the state's procurement bureaucracy, which imposes huge administrative burdens "just to get paperclips." End note.) GOK control over Samruk, Evans said, rests with Deputy Prime Minister Karim Masimov, whom he called "the de facto owner." The GOK, according to Evans, is serious about bringing about "a transparent way of government." But this "won't sit well with the way some of these companies are run." "There is already some discomfort," Evans continued, "in areas like audit and debate on how it should be done. The government has excessive expectations on how fast the results will come. Some of this is cultural."

Samruk Becomes an "Investor"

¶10. (SBU) "All of the five [original] companies have pretty substantial growth prospects," said Evans. He acknowledged that with the current round of expansion, Samruk is considering adopting an investment strategy. (Note: Samruk's initial focus was only on the management of state assets. End note.) However, he added, Samruk already has its hands full and should limit its investment activity to the core areas of its original five companies. Another problematic issue here, he said, is the possibility of competing with Kazyna, which "makes no sense." (Note: The Kazyna Fund for Sustainable Development is the GOK's other holding company, encompassing a number of state-owned institutions charged with realizing the GOK's goal of economic diversification away from energy. End note.) "My feeling," Evans continued, "is that eventually, there needs to be some sort of co-existence with Kazyna. Not a merger but a superstructure."

The Plan for Air Astana: Hire Crews, Lease Planes

¶11. (SBU) Addressing Air Astana, Evans said he believes the airline should continue to lease, not buy, its aircraft. He also stated that the decision should rest with professional managers, not the government. Between now and fall 2007, he said, the airline needs to hire an additional 600 to 700 crew members, adding to the current total of 2,300. Air Astana is also considering a long-term training program for pilots, Evans said. (Note: Another Samruk insider tells us that there is a plan for the GOK and BAE Systems to draw down their ownership of Air Astana in parallel; the resulting shares will be distributed to the airline's employees. End note.)

¶12. (SBU) On the choice between Boeing and Airbus aircraft, Evans said "in narrow-body aircraft, the products are very similar; what swings the decision is advantages in maintenance. In wide bodies, Boeing is better. The 777 is probably the best product."

Comment

¶13. (SBU) Comment: Samruk's current expansion, which its executives have told us will not be the last, signals growth not only in the company's size but also its mandate. Towering over 22 state-owned companies, Samruk looks quite different from its original incarnation as the holding company dedicated merely to professional management of "strategic state assets." Notably, with the arrival of "the new 17," Samruk already finds itself as a minority shareholder in two companies; the number is likely to increase as

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the GOK sheds shares through planned IPOs and privatizations. It is still unclear whether Samruk will become primarily a stepping stone for privatizing state-owned companies or a de facto investment vehicle for the GOK. In a sign that Samruk may not be too quick to relinquish to the market much of its newly acquired holdings, one insider told us that a new government resolution will soon formalize Samruk's mandate not only as a "management company" but an "investment company" as well. End comment.

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